

# **Lease Cost Review 2004**

## **AGENDA**

- I. Introductions**
- II. Purpose**
- III. Historic Information on Private Office Space Leases**
- IV. Market Factors**
- V. Recommendations For FY 2006 and FY 2007**
- VI. Background for State Owned or Leased Buildings**
- VII. Appendix**

**I.**

**INTRODUCTIONS**

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## **II.**

### **PURPOSE**

**Pursuant to A.E.S. 41-792 the goals are:**

1. To estimate an average square foot dollar cost for FY2006 and FY2007 for leasing privately owned office space.
2. Recommend to the Department of Administration, Director's Office a rental rate to be charged to state agencies for using space in buildings owned by or leased to the state.

### **III.**

#### **HISTORIC INFORMATION ON PRIVATE OFFICE SPACE LEASES**

The General Services Division of the Arizona Department of Administration has responsibility for reviewing and maintaining records on all leases in the ADOA building system. Specifically excluded are buildings that are part of the University system, which is governed by the Board of Regents, and all buildings within the Department of Transportation building system.

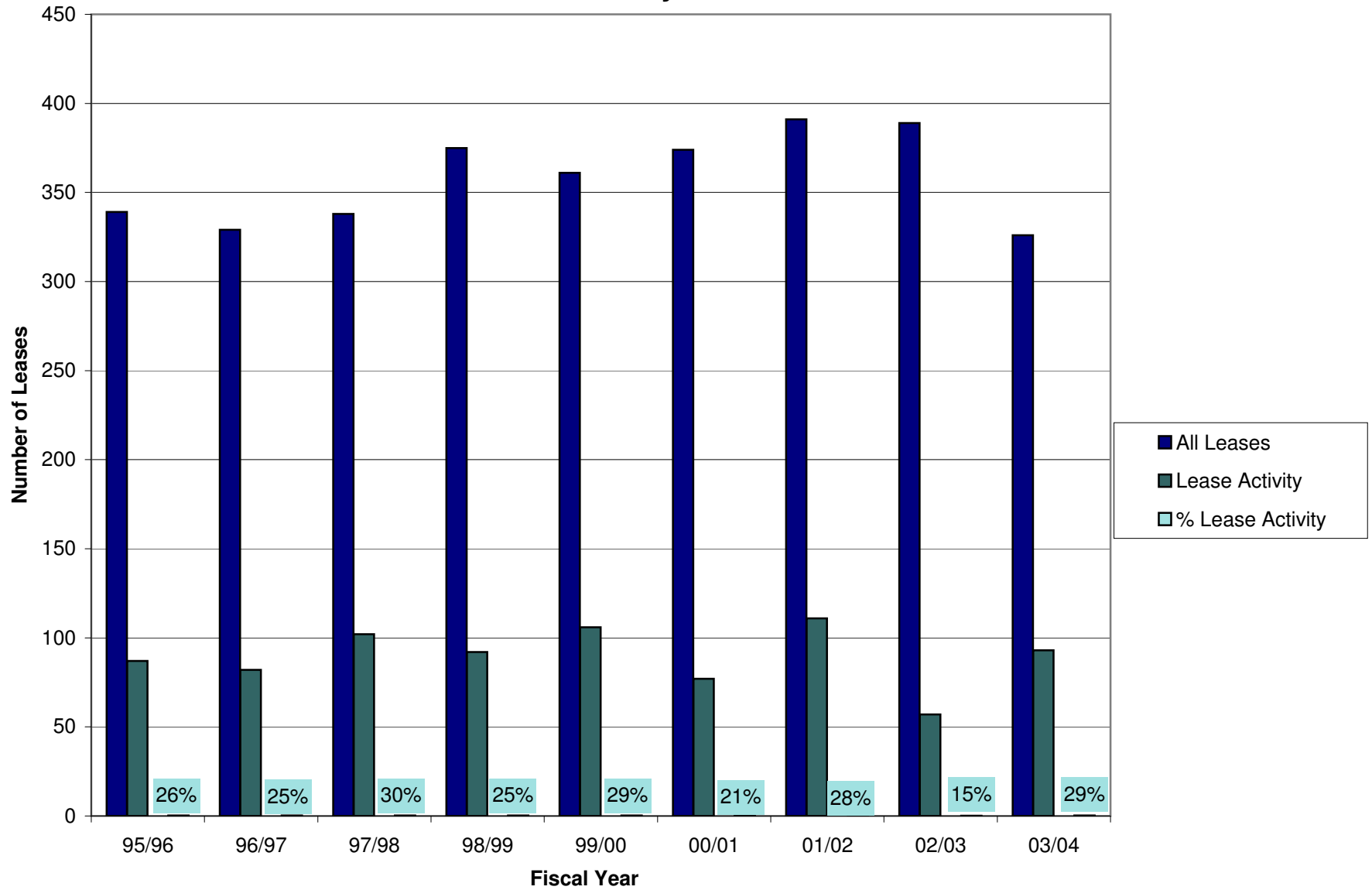
The database includes 326 active leases. In the past nine years, between 15% and 30% of these leases required some action; - new, amendments or renewals. (Exhibit A)

From 1996 to 2002, leased office space increased from 2.3 to 3.2 million, at an average of 5% per year. From 2002 to 2004, leased space decreased by 500,000 square feet, as three new buildings were added on to the Mall. (Exhibit B)

From 1996 to 2002, annual rent for leased space increased from \$29 to 49 million, at an average of 10% per year. From 2002 to 2004, annual rent for leased space decreased from \$49 million to \$40 million, as three new buildings were added on to the Mall. (Exhibit C)

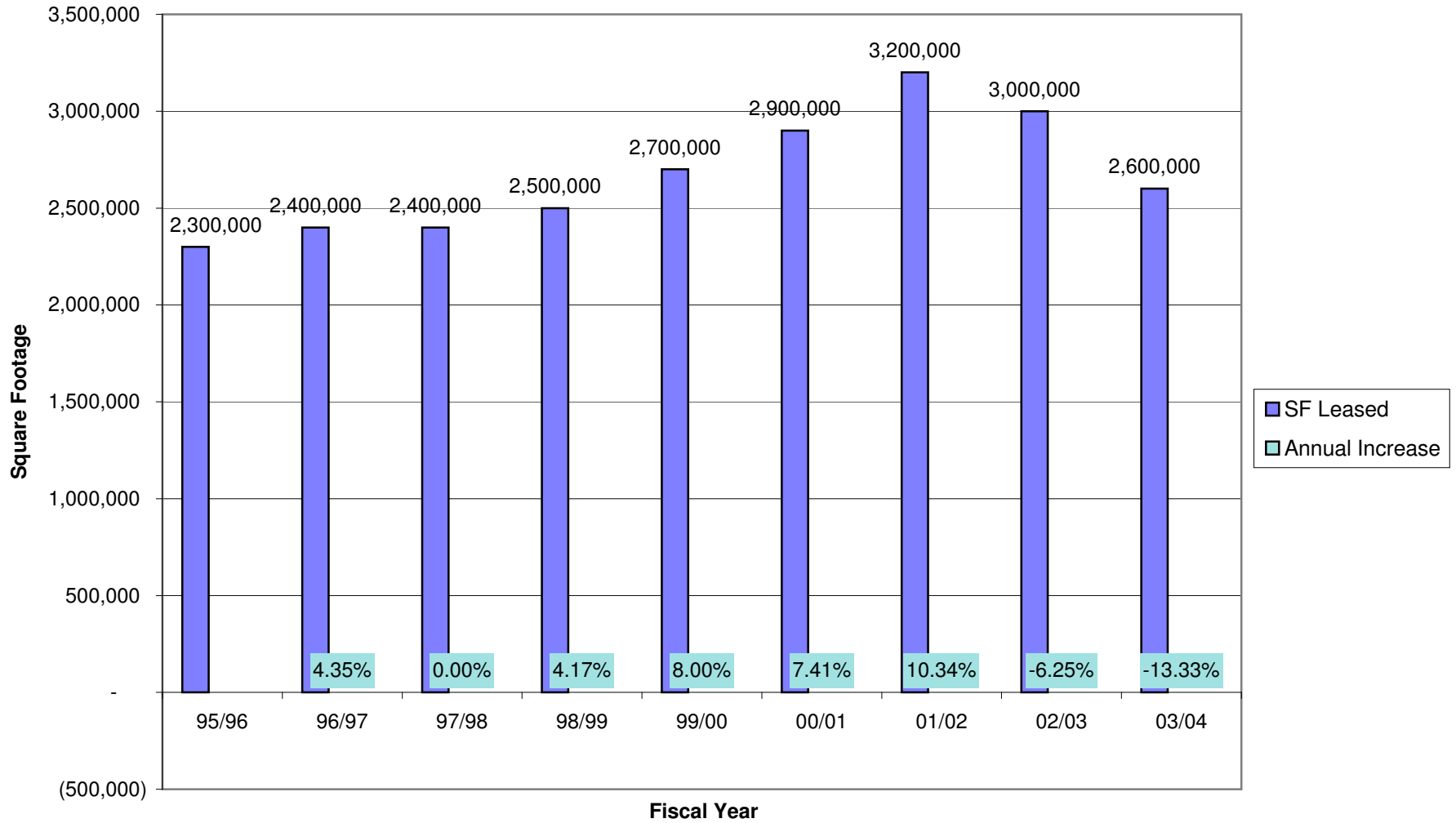
The graphs included in this report show both historical leasing data and projections based on our evaluation of current market conditions and trends.

## Lease Activity



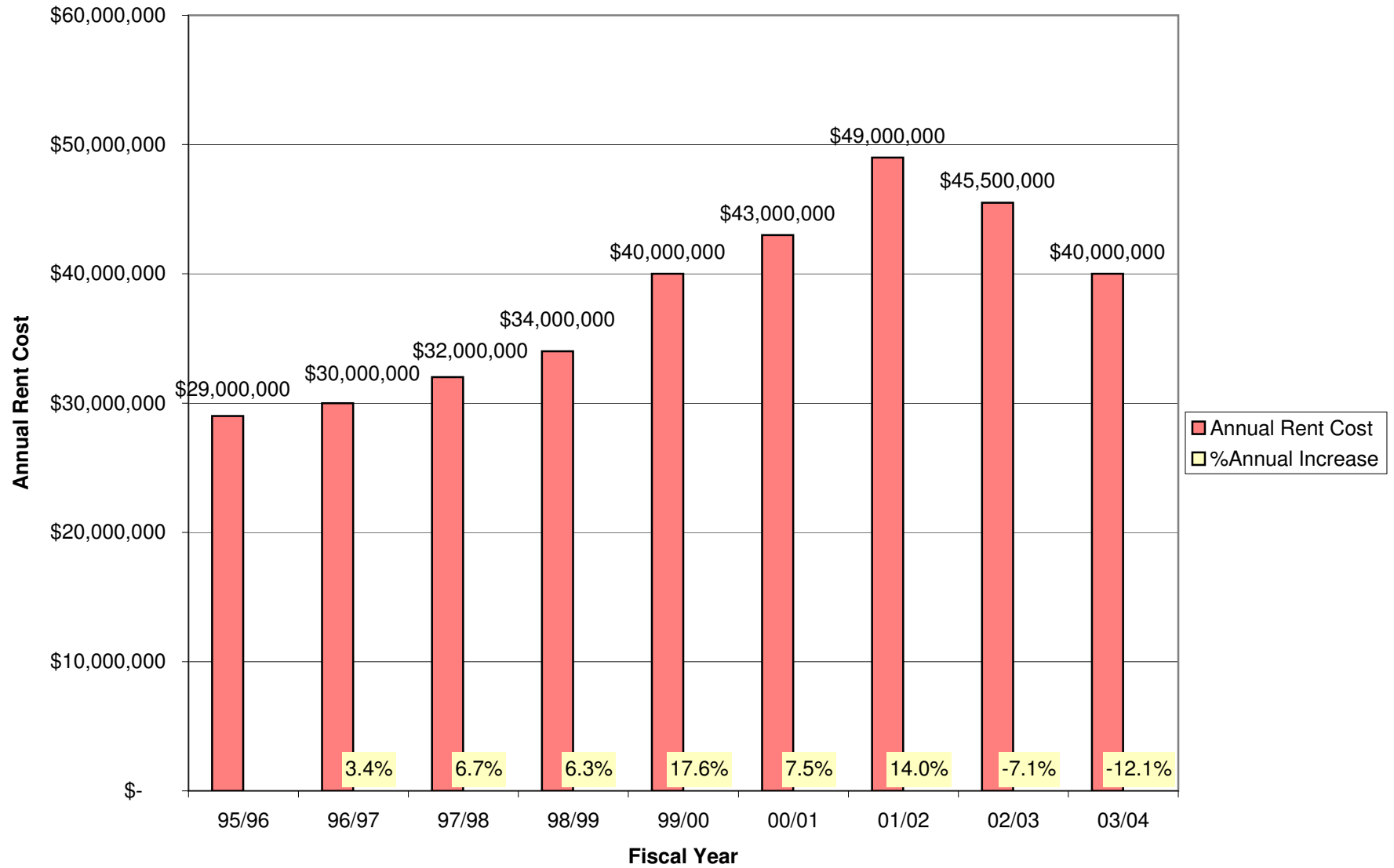
## Exhibit A

## Leased Space Square Footage Trends



## Exhibit B

## Annual Lease Cost



## Exhibit C



## **IV.**

### **MARKET FACTORS**

#### **A. Current Market**

According to CB Richard Ellis, the current market is in a state of transition. Vacancy rates have seen four consecutive quarterly declines to a current 17.6%. Absorption is up to 379,000 square feet for the first quarter in 2004 versus 302,000 square feet in the first quarter in 2003. New construction for the first quarter was 1 million square feet reflecting confidence on the part of developers in a strengthening economy. However, rental rates have yet to reflect this strength, even showing a slight decline in the first quarter to an average rental rate of \$19.06 (all classes). This should turn around as the economy continues to recover.

#### **B. Market Rates – Maricopa County**

Class B office space comprises the majority of State leased space. The annual rate per square foot for Class B office space was \$18.09, excluding rental tax, at the end of the first quarter 2004.

#### **C. Market Rates – Outside Market County**

Rates outside of the Phoenix metro area, while generally lower, are more volatile, reflecting the lack of inventory and competitive market conditions prevailing in smaller cities and towns. Information is limited for rates in the Tucson and Flagstaff areas.

#### **D. Projections**

The cost of all leases in the database for FY04 averaged \$15.17 per square foot. This reflects a 2% increase from FY03, which was \$14.97 per square foot. The increase is mostly due to the few rent escalations specific leases have in our database. Overall, the market is increasing slightly and will continue to do so slowly and steadily.

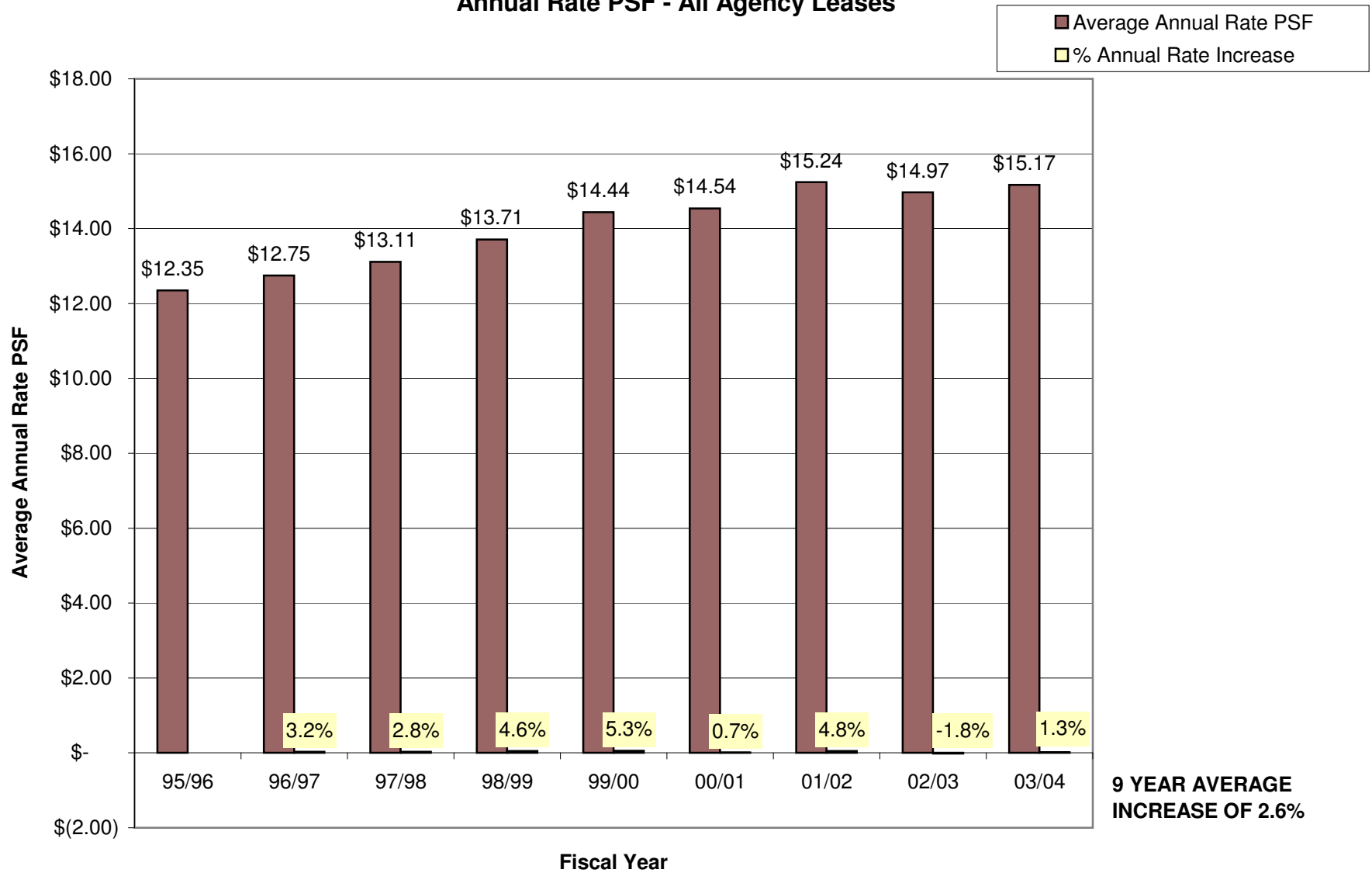
## **V.**

### **RECOMMENDATIONS FOR FY 2004 AND FY 2005**

#### **Privately Owned Office Space**

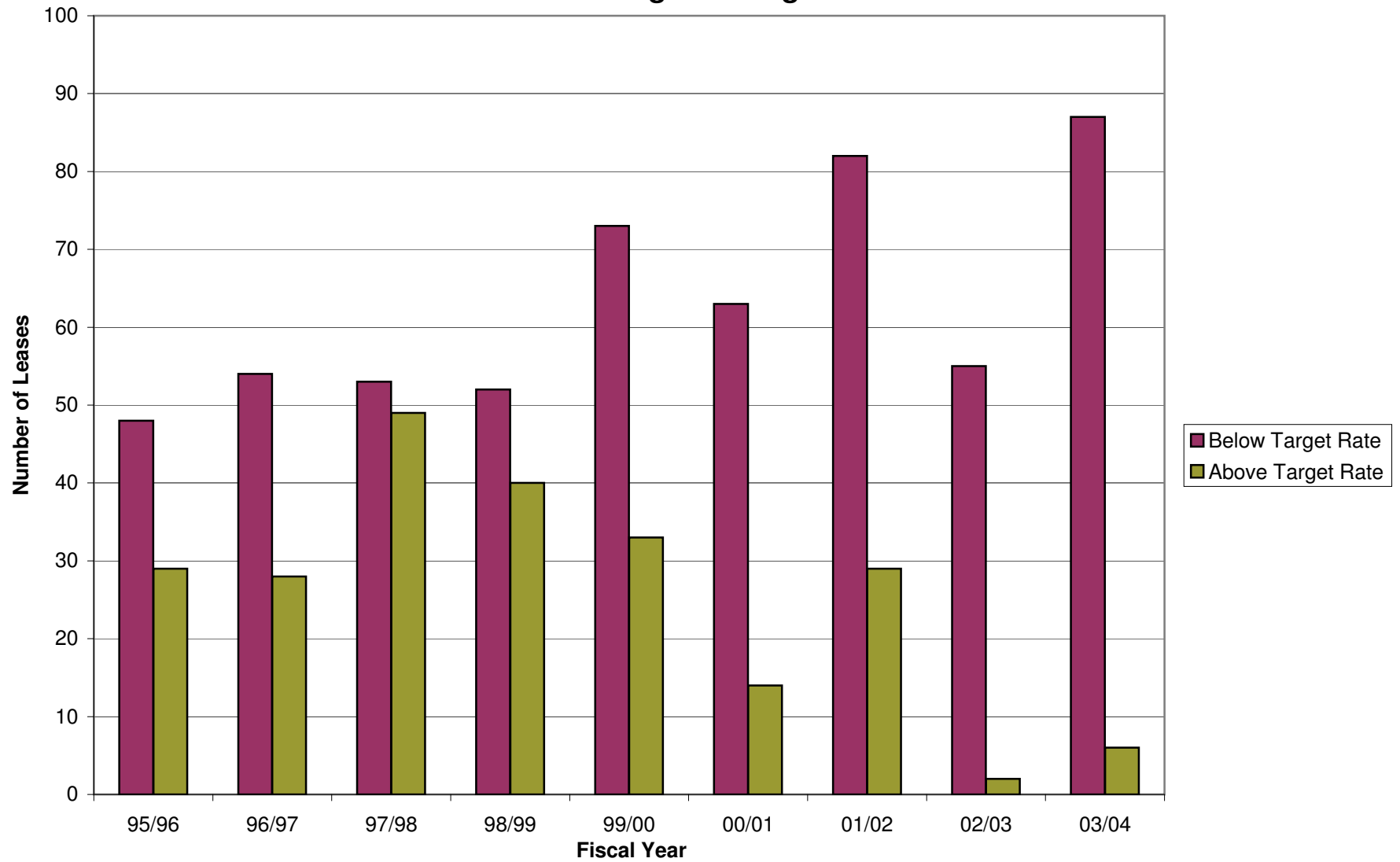
- All leases in the database averaged \$14.97 per square foot in FY03 and averaged \$15.17 per square foot in FY04. Over the past nine years the average cost has increased by 2.6% per year (Exhibit D).
- For FY04, 87 of 96 (94%) new and renewed leases were written at rates below the LCRB target average rate of \$18.25 (Exhibit E).
- The current average rate of \$15.17 is below both the recommended rate of \$18.25 and the current market rate of \$18.09 for Class B space (Exhibit F). Therefore, there is no compelling reason to raise the recommended rate at this time.
- Recommendations: The Department of Administration staff recommends an annual rate of \$18.25 per square foot for private lease space during FY2006 and \$18.25 during FY2007.

### Annual Rate PSF - All Agency Leases



## Exhibit D

### Leases Below Target Average



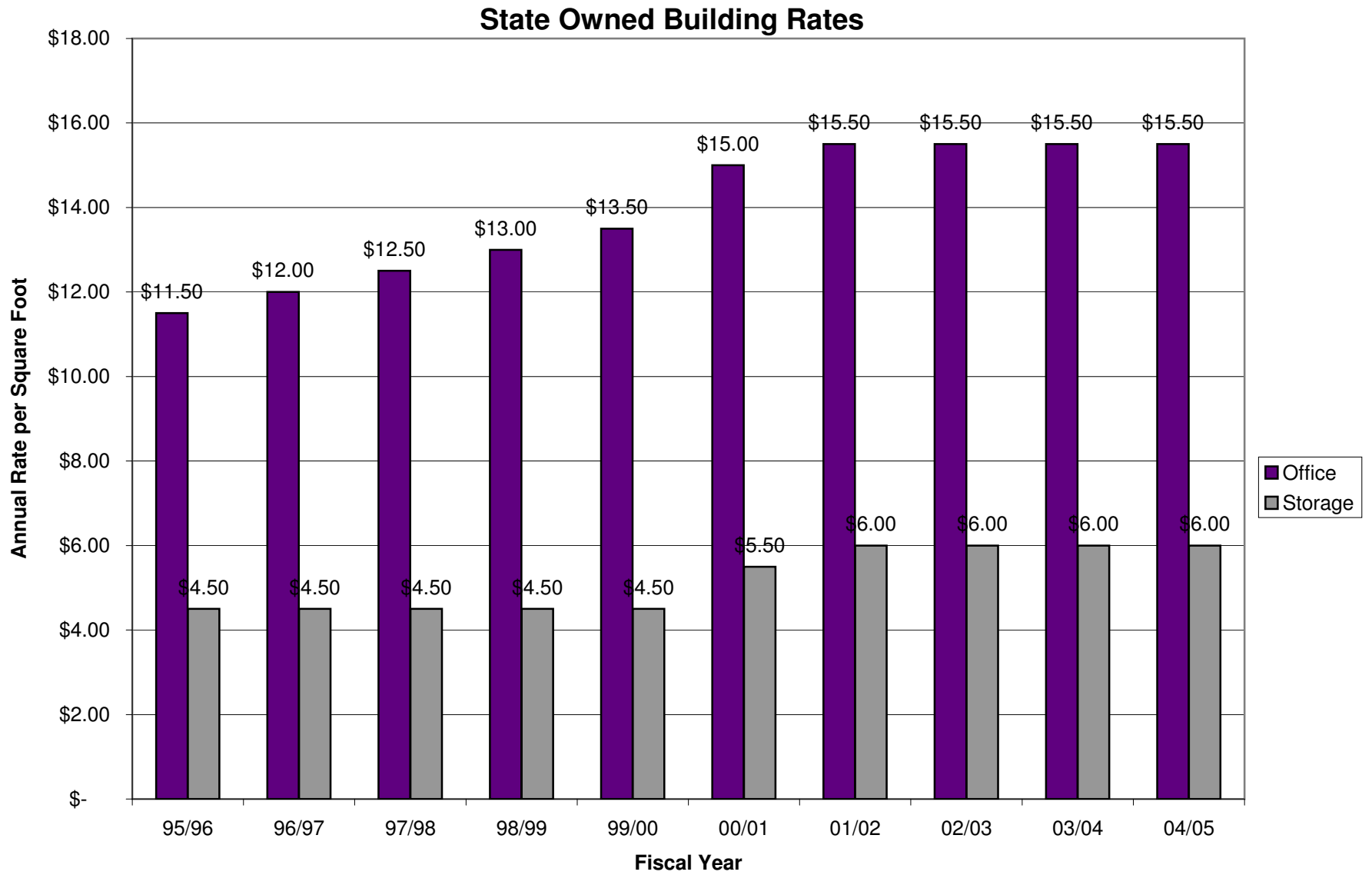
### Exhibit E



## Exhibit F

LEASE COST REVIEW BOARD, MEMBERS, DUTIES, SQUARE FOOTAGE LEASE COSTS

- A. A lease cost review board is established. Board membership consists of the director or the director's designee and four members appointed by the director, as follows:
  - 1. Three directors of other state agencies.
  - 2. A staff member of the joint legislative budget committee.
- B. The term of office of appointed members is three years. A director of a state agency may appoint an employee of the agency to serve on the committee in the director's stead.
- C. Before July 1 of each even-numbered year, the lease cost review board shall:
  - 1. Estimate an average square foot dollar cost for the following two fiscal years for leasing privately owned office space.
  - 2. Recommend to the director a rental rate to be charged to state agencies for using space in buildings owned by or leased to this state.
- D. Leases proposed to be entered into by a state agency for privately owned office space must be approved by the director, or in the case of the state universities, by the Arizona board of regents. Before August 1 of each even-numbered year, the director and the board shall each submit a report to the joint committee on capital review that lists all leases that were approved during the prior two fiscal years and that exceeded the average square foot dollar cost estimated for the prior fiscal year pursuant to subsection C.



## Exhibit G